Report

of the

Examination of

Lodi Mutual Insurance Company

Lodi, Wisconsin

As of December 31, 2003

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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August 6, 2004

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2003, of the affairs and financial condition of:

LODI MUTUAL INSURANCE COMPANY
Lodi, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of Lodi Mutual Insurance Company (hereinafter, also the company) was made in 1999 as of December 31, 1998. The current examination covered the intervening time period ending December 31, 2003, and included a review of such subsequent transactions deemed essential to complete this examination.

The “Summary of Examination Results” contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was organized as a town mutual insurance company on March 28, 1877, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Lodi Farmers’ Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there were two amendments to the articles of organization and no amendments to the bylaws. An amendment to the articles of organization in 2002 altered the location of the annual policyholder meeting. Another amendment to the articles of organization was approved by policyholders in March 2004 and approved by OCI in August 2004. The amendment reduces the number of board members from six to five.

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance. The company is currently licensed to write business in the following counties:

Columbia
Sauk
Dane

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of three years with premiums payable on the advance premium basis. Policy fees charged to policyholders for renewal policies are retained by the agent (see table below).

Business of the company is acquired through five agents, all of whom are directors of the company. Agents are presently compensated for their services as follows:

Type of Policy	**Compensation**
Fire and Extended Coverage	6 % + $3.00 ($5.00 minimum commission on renewals)
Liability	15%

Agents have authority to adjust losses up to $5,000. Losses in excess of this amount are adjusted by either two directors or an outside adjuster. Losses in excess of $20,000 are required to be adjusted by an outside adjuster. Adjusters receive $20/visit for each loss adjusted.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of organization.

Board of Directors

The board of directors consists of five members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Frank Groves *	Retired UW Professor	Lodi, WI	2005
Harland Hartmann *	Retired Farmer	Lodi, WI	2007
Vicki Kearney *	Lodi Mutual general manager	Lodi, WI	2006
Ronald Kohn *	Farmer	Lodi, WI	2007
Patrick Lochner *	Dairy Farmer	Lodi, WI	2005

Directors who are also agents are identified with an asterisk.

Members of the board currently receive $40 for each meeting attended and $.32/mile for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified. Officers serving at the present time are as follows:

Name	Office	2003 Salary
Frank Groves	President	$ 200
Harland Hartmann	Vice President	---
Vicki Kearney	Secretary/Treasurer and general manager	32,000

The general manager also receives $4,200 for rent because the company's office is located inside her private residence.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. At the time of this report, the company had not appointed any committees.

Growth of Company

The growth of the company since the previous examination as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2003	$ 85,129	373	$(33,027)	$659,743	$493,479
2002	90,487	362	30,099	674,426	531,075
2001	85,293	332	1,278	652,944	510,299
2000	78,841	343	(37,405)	669,603	512,169
1999	98,601	347	49,056	651,902	540,487
1998	101,379	370	(18,969)	604,199	490,227

The ratios of gross and net premiums written to surplus as regards to policyholders since the previous examination were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Net	Writings Ratios Gross
2003	$260,045	$ 94,519	$493,479	19%	53%
2002	236,818	93,874	531,075	18	45
2001	213,966	87,847	510,299	17	42
2000	204,883	84,577	512,169	17	40
1999	192,332	100,083	540,487	19	36
1998	179,543	105,646	490,227	22	37

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Com-posite Ratio
2003	$62,276	$65,764	$ 85,129	73%	70%	143%
2002	23,704	52,201	90,487	26	56	82
2001	46,094	60,343	85,293	54	69	123
2000	85,376	57,189	78,841	108	68	176
1999	17,495	55,511	98,601	18	55	73
1998	93,438	51,541	101,379	92	49	141

In review of the company’s financial data and reinsurance agreements, it appears that in order for the company to break even at its current expense ratio, a loss ratio of 35% or lower is required. During the period under review, the company has demonstrated that it can attain this, but not consistently. Two out of the five years under review showed a loss ratio of 35% or lower. This impacts the company’s ability to increase its surplus, which has increased less than 1% since the last examination by this office.

Increasing reinsurance costs have impacted the company's ability to report a loss ratio necessary to break even. Although gross premiums have increased 45% since 1998, increased reinsurance costs have reduced net premiums by 11% from 1998. Also, the percentage of premiums retained by the company in 2003 was 36% compared to 59% in 1998. Reinsurance costs have increased due to large recoveries from the reinsurer in 1998 and 2001. Net underwriting expense dollars have increased 27% since 1998, compared to gross premiums increasing by 45%; however, because net premiums written have decreased (due to higher reinsurance costs), the underwriting expense ratio has increased from 49% to 70%.

Also, the company's loss ratio will vary significantly due to the concentration of risk in one geographic area. This concentration will tend to polarize the loss ratio between years, allowing the company to report large gains in years of low loss, but report large losses when a storm hits its concentrated territory. For example, the company reported a gross loss ratio of 284% in 1998, 6% in 1999 and 13% in 2002; as a result, there was a net loss in 1998 and substantial net income in 1999 and 2002.

The company has also been challenged with low interest rates on its investments, which is a challenge that is not isolated to this company alone. The company's investments are concentrated in Certificates of Deposit. Net investment income earned has decreased by 58% from $23,461 in 1999 to $9,884 in 2003.

Management stated that the company expects reinsurance costs to decrease in the future, which should help to reduce the expense ratio and improve the likelihood of earning a net income. However, the company would benefit by considering contingencies in the event that reinsurance costs do not decline in the near future. One such contingency would be to merge with another town mutual insurance company. Potentially, this could reduce expense ratios and spread the company's risks away from its concentrated area.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2004
Termination provisions:	Either party may terminate the contract or any attached exhibits as of 12:01a.m. Central Standard Time, January 1, 2005, or any subsequent January 1, by giving to the other party at least 90 days' advance notice in writing. Business shall be terminated according to each exhibit.

The coverages provided under this treaty are summarized as follows:

1.	Type of contract:	Class A Casualty Quota Share Reinsurance
	Lines reinsured:	Nonproperty
	Company's retention:	None
	Coverage:	100% of each and every loss, including loss adjustment expense, occurring on the business covered by this exhibit, subject to the maximum policy limits stated below.
	Reinsurance premium:	100% of premium written
	Ceding commission:	15%
	Termination:	Company can elect either runoff or cutoff
2.	Type of contract:	Class B First Surplus Reinsurance
	Lines reinsured:	Property
	Company's retention:	Retained pro rata portion of each risk
	Annual aggregate deductible:	10% of Loss and LAE that is recoverable
	Coverage:	When the company's net retention is $200,000 or more in respect to a risk, the company may cede on a pro rata basis, and the Reinsurer shall be obligated to accept up to $800,000. When the company's net retention is $200,000 or less in respect to a risk, the company may cede on a pro rata basis and the Reinsurer shall be obligated to accept up to 50% of such risk.

	Reinsurance premium:	The pro rata portion of all premiums, fees, and assessments charged by the company, corresponding to the amount of each risk ceded hereunder.
	Ceding commission:	The Reinsurer shall make a commission allowance to the company of 15% of the premium paid to the Reinsurer under this Exhibit. Return commission shall be allowed at the same rate on all return premiums paid to the company. The Reinsurer shall pay the company a profit commission of 15% of the net profit, if any, accruing to the Reinsurer during each accounting period defined herein.
	Termination:	Cutoff
3.	Type of contract:	Class C-1 First Layer Excess of Loss Reinsurance
	Lines reinsured:	Property
	Company's retention:	$20,000
	Coverage:	100% of any loss including loss adjustment expense, in excess of the company's retention, subject to an $80,000 limit of liability in respect to each and every loss occurrence.
	Annual aggregate deductible:	In addition to the net retention of the company for each and every risk, as outlined above, the company shall retain, as an Annual Aggregate Deductible, an amount equal to $20,000 of loss which would otherwise be recoverable hereunder for each annual period this Exhibit is in effect.
	Reinsurance premium:	A variable percentage of the net premiums written (NPW) based on the loss experience for the prior four years. Minimum rate: 7.00% of NPW Maximum rate: 16.80% of NPW (Current rate for 2004: 12.50%) Deposit premium: $17,400; minimum premium: $14,000
	Termination:	Cutoff
4.	Type of contract:	Class C-2 Second Excess of Loss
	Lines reinsured:	Property
	Company's retention:	$100,000
	Coverage:	100% of any loss, including loss adjustment expense, in excess of $100,000, subject to a $100,000 limit of liability in respect to each and every risk resulting from one loss occurrence.
	Reinsurance premium:	7.20% of the company's current net premiums written Deposit premium: $9,900; minimum premium: $8,000

	Termination:	Cutoff
5.	Type of contract:	Class D/E – First Aggregate Stop Loss Reinsurance
	Lines reinsured:	All lines of business written by the company
	Company's retention:	Losses, including loss adjustment expenses, in an amount equal to not less than 80% of net premium written, subject to a minimum retention of $89,000.
	Coverage:	100% of losses in excess of the company's retention.
	Reinsurance premium:	The sum of the eight years' losses incurred by the Reinsurer divided by the total of the net premiums written for that same period multiplied by the factor of 100/80ths. Minimum rate: 10.00% NPW Maximum rate: 25.00% NPW (Current rate for 2004: 15.00%) Deposit premium: $21,000; minimum premium $17,000
	Termination:	Cutoff

III. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2003, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Lodi Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2003

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash deposited in checking account	$ 42,507	$	$	$ 42,507
Cash deposited at interest	505,000			505,000
Stocks and mutual fund investments	90,655			90,655
Premiums and agents' balances:				
In course of collection	5,513			5,513
Investment income accrued		3,429		3,429
Electronic data processing equipment	5,033			5,033
Other expense related assets:				
Reinsurance contingent commission receivable	7,606			7,606
Totals	$656,314	$3,429	$ 0	$659,743

Lodi Mutual Insurance Company
Statement of Assets and Liabilities (cont.)
As of December 31, 2003

Liabilities and Surplus

Net unpaid losses	$ 4,580
Unpaid loss adjustment expenses	200
Commissions payable	6,174
Fire department dues payable	113
Unearned premiums	90,183
Reinsurance payable	24,853
Amounts withheld for the account of others	1,099
Payroll taxes payable (employer's portion)	420
Other liabilities:	
Expense related:	
Accounts payable	450
Nonexpense related:	
Premiums received in advance	38,192
Total Liabilities	166,264
Policyholders' surplus	493,479
Total Liabilities and Surplus	$659,743

Lodi Mutual Insurance Company
Statement of Operations
For the Year 2003

Net premiums and assessments earned		$ 85,129
Deduct:		
Net losses incurred	$54,649	
Net loss adjustment expenses incurred	7,627	
Other underwriting expenses incurred	65,764	
Total losses and expenses incurred		128,040
Net underwriting gain (loss)		(42,911)
Net investment income:		
Net investment income earned	9,884	
Total investment gain (loss)		9,884
Net Income (Loss)		$(33,027)

Lodi Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2003

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	2003	**2002**	**2001**	**2000**	**1999**
Surplus, beginning of year	$531,075	$510,299	$512,169	$540,487	$490,227
Net income	(33,027)	30,099	1,278	(37,405)	49,056
Net unrealized capital gains or (losses)	(4,569)	(9,323)	(3,148)	8,771	888
Change in nonadmitted assets	0	0	0	316	316
Surplus, end of year	$493,479	$531,075	$510,299	$512,169	$540,487

Reconciliation of Policyholders' Surplus

A reconciliation of the policyholders' surplus as reported by the company in its filed annual statement and as determined by the examination is detailed in the following schedule:

Policyholders' surplus per December 31, 2003, annual statement			$493,479
Item	**Increase**	**Decrease**	
Premium in course of collection	$	$5,513	
Total	$	$5,513	
Decrease to surplus per examination			5,513
Policyholders' Surplus per Examination			$487,966

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Underwriting—It is recommended that the company establish a formal inspection procedure for new and renewal business, whereby a sampling of new applications and renewal business is inspected by committee members independent of the risk under consideration.

   Action—Compliance

2. Underwriting—It is recommended that the company file an amended ceding slip with its reinsurer whenever there is a change in coverage on a property.

   Action—Compliance

3. Invested Assets—It is recommended that the company comply with s. Ins 13.05 (4) (f), Wis. Adm. Code, by requiring the presence and signature of at least two directors, officers, or employees of the company when accessing the safety deposit box.

   Action—Compliance

4. Invested Assets—It is recommended that the company adopt a written investment plan to comply with the requirements of s. Ins 6.20 (6) (h), Wis. Adm. Code.

   Action—Compliance

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and committees thereof, were reviewed for the period under examination and also for the subsequent period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

During the review of the minutes of the board of directors, it was noted that the minutes did not identify when a director abstained from a vote where there was a conflict of interest. In these cases, the director was also an employee of the company and the resolution being voted on was the employee’s contract. Identifying when directors abstain from this and similar votes would add credibility to the company’s claim that directors do not have conflicts of interest. It is recommended that the minutes of the board of directors identify when a director abstains from a vote where there is a conflict of interest.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity bond	$ 35,000
Worker's Compensation:	
Employee injury	Statutory
Employee liability:	
Each accident	100,000
Each employee	100,000
Policy limit	500,000
Insurance Company Combined Professional liability Directors and Officers Insurance	
Per claim & Aggregate Limit	1,000,000
Per claim deductible	2,500
Insurance Agents Errors and Omissions policy	
Per claim and aggregate limit	1,000,000
Per claim deductible	2,500
Commercial liability	
General Aggregate Limit	1,000,000
Each occurrence limit	1,000,000
Personal & advertising injury limit (any 1 person or organization	1,000,000
Damage to premises rented to you (any on premises)	100,000
Medical Expense limit (any one person)	5,000

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection procedure for both new and renewal business. A sampling of new applications and renewal business is inspected by committee members who are independent of the risk under consideration and review.

During testing, the examiners noted that not all of the policies had a signed undertaking to pay premiums and assessments, which acknowledges that the policyholder is obligated to pay premiums and any assessments should they be levied by the company. An applicant for insurance is required to sign an undertaking to pay premiums and assessments pursuant to s. 612.52, Wis. Stat. The signatures were missing because some of the company's older applications did not include the undertaking to pay premiums and assessments. The company has since changed the applications to include a statement of undertaking. However, it is recommended that the company obtain signatures for the undertaking to pay premium and assessments for all policies that are currently in force, as required by s. 612.52, Wis. Stat.

Claims Adjusting

The company does not have an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of an adjusting committee is to adjust or supervise the adjustment of losses. It is recommended that the company comply with s. 612.13 (4), Wis. Stat., by appointing an adjusting committee and noting the committee members in the board minutes.

It was identified that the board of directors serves in a similar capacity to an adjusting committee. A simple method of complying with the recommendation made in the previous paragraph would be to appoint the entire board to the adjusting committee.

All directors of the company are agents and are authorized to adjust claims.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

A policy register is maintained in the company’s computer system; however, the total number of policies in-force and the total in-force premium as determined in the examination did not agree to Schedule M in the 2003 annual statement. Work performed by the examiners determined that there were 396 policies in-force at year-end 2003, rather than the 373 reported by the company. It is recommended that the company correctly report information on Schedule M according to the Town Mutual Annual Statement Instructions.

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2003.

The company is not audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's electronic data processing environment. Access to the computer is limited to people authorized to use the computer.

Company personnel back up the computers daily and monthly data is stored off-site. In addition, hard copies of key data are generated quarterly and stored off-site.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

Business Continuity Plan

A business continuity plan identifies steps to be performed by a company in the event of business interruptions including, but not limited to, the inability to access its computer, the loss of information on its computer, the loss of a key employee, or the destruction of its office building. The company has developed a business continuity plan. The company's business continuity plan appears to be adequate.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

(1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and

(2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The examiners noted two instances of noncompliance with this regulation. In one instance, the company was unable to present one of its preferred stock certificates. Existence of the investment was proved by the receipt of dividends in 2004. A reissued certificate was obtained by the company subsequent to the end of field work. The examiners also learned that the company had made a bond investment in 2004 that is held by a party that is not a custodian bank.

It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards custody and control of its invested assets.

Investment Rule Compliance

The investment rule for town mutual insurers allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as “Type 2”) provided that the town mutual has a sufficient amount of lower risk investments (referred to as “Type 1”). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$466,264
2.	Liabilities plus 33% of gross premiums written	252,079
3.	Liabilities plus 50% of net premiums written	213,524
4.	Amount required (greater of 1, 2, or 3)	466,264
5.	Amount of Type 1 investments as of 12/31/2003	525,000
6.	Excess or (deficiency)	58,736

The company has sufficient Type 1 investments.

It is noted that on the Schedule of Investment Limitations in the annual statement submitted to OCI, the company reported a Type 1 excess of $90,655. The difference between the amount reported on the annual statement, and the amount above is the amount exceeding the FDIC insurance limit of $100,000 in one financial institution. Amounts not covered by the FDIC limits are considered Type 2 under s. Ins 6.20 (6), Wis. Adm. Code. It is recommended that the company complete the Schedule of Investment Limitations according to the Town Mutual Annual Statement Instructions and s. Ins 6.20 (6), Wis. Adm. Code.

ASSETS

Cash and Invested Cash **$547,507**

The above asset is comprised of the following types of cash items:

Cash deposited in banks-checking accounts	$ 42,507
Cash deposited in banks at interest	505,000
Total	$547,507

Cash deposited in banks subject to the company's check and withdrawal consists of one account. Verification of the checking account balance was made by obtaining confirmation directly from the depository and reconciling the amount shown thereon to company records.

Cash deposited in banks at interest represents the aggregate of 26 deposits in six depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2003 totaled $8,888 and was recalculated by the examiners and appeared reasonable. Rates of interest earned on cash deposits ranged from 1.00% to 4.25%. Accrued interest on cash deposits totaled $3,429 at year-end.

Stocks and Mutual Fund Investments **$90,655**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2003. Stocks owned by the company are located in the company’s safety deposit box.

Stock certificates were physically examined by the examiners, and it was noted that the company was unable to present a preferred stock certificate that should have been located in the company’s safety deposit box. See the recommendation in the Invested Assets section of this report. There were no stock or mutual fund purchases in the period under examination. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2003 on stocks and mutual funds amounted to $3,970 and were traced to cash receipts records. There were no accrued dividends at December 31, 2003.

Premiums, Agents' Balances in Course of Collection **$0**

The examiners identified that the company reported a balance on the annual statement of $5,513. This consisted of premium for policies that had an effective date in 2004, and for amounts that were overdue by more than 90 days. Since both circumstances do not agree with the annual statement instructions, the examination has adjusted the balance to zero. It is recommended that the company comply with annual statement instructions regarding Premiums, Agents' Balances in Course of Collection.

Investment Income Due and Accrued **$3,429**

Interest due and accrued on the various assets of the company at December 31, 2003, consists of the following:

Cash at interest	$ 3,429
Total	$ 3,429

Electronic Data Processing Equipment **$5,033**

The above balance consists of computer hardware and operating system software, net of depreciation as of December 31, 2003. A review of receipts and other documentation verified the balance. Non-operating system software was properly nonadmitted.

Reinsurance Contingent Commission Receivable **$7,606**

The above asset represents the amount of reinsurance commissions that the company expected to receive as of December 31, 2003, based on the profitability of the business ceded under its contract with Wisconsin Reinsurance Corporation. A review of the terms of the reinsurance agreement and year-end accountings with the reinsurer verified the above asset.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$4,580**

This liability represents losses incurred on or prior to December 31, 2003, that remained unpaid as of that date. The examiners reviewed the reasonableness of this liability by totaling actual loss payments made subsequent to December 31, 2003, with incurred dates in 2003 and prior years. To the actual paid loss figure was added an estimated amount for 2003 and prior losses remaining unpaid at the examination date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	Company Estimate	Examiners' Development	Difference
Incurred but unpaid losses	$15,443	$15,220	$223
Less: Reinsurance recoverable on unpaid losses	10,863	10,737	126
Net Unpaid Losses	$ 4,580	$ 4,483	$ 97

The above difference of $97 was not considered material for purposes of this examination. The examiner did not include the nonproperty in the development because it is 100% reinsured and records are maintained with the reinsurer.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

Unpaid Loss Adjustment Expenses **$200**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2003, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is to calculate an estimate based on the number of open claims multiplied by an average loss adjusting expense amount.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

Commissions Payable **$6,174**

This liability consists of amounts due to agents but not paid until after year-end. Supporting records and subsequent cash disbursements verified this balance.

Fire Department Dues Payable **$113**

This liability represents the fire department dues payable at December 31, 2003. The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Unearned Premiums **$90,183**

This reserve was established by multiplying the company’s gross premium written by 50% and reduced by unearned premium ceded to the company’s reinsurer. This liability should represent the reserve established for unearned premiums under s. Ins 13.08 (3), Wis. Adm. Code, which states that the full term premium should be used for calculating unearned premiums. During the course of fieldwork, it was determined that the difference between the two calculations was immaterial and an adjustment to surplus was not necessary. In order to avoid a material difference between the two methods in the future, it is recommended that unearned premiums be calculated from the company’s full term premium as stated in s. Ins 13.08 (3), Wis. Adm. Code.

During the testing of unearned premiums, the examiners identified that computer software used by the company generates a report that calculates unearned premium by using the daily pro rata method. In order to use this method, the company needs to obtain permission from OCI, according to s. Ins 13.08, Wis. Adm. Code. This requirement was necessary when computers were first used to perform the daily pro rata calculation and software users required a level of familiarity in computer programming to perform the calculation. Since then computer software has been designed for the user’s ease, and the examiners witnessed the company’s ability to produce the report.

Use of the daily pro rata method to calculate unearned premium on a going forward basis is hereby approved by this office. It is suggested that the company use the daily pro rata method to calculate unearned premiums on a going forward basis.

Reinsurance Payable **$24,853**

This liability consists of amounts due to the company's reinsurer at December 31, 2003, relating to transactions which occurred on or prior to that date.

Class A	$ 2,025
Class B	0
Class C-1	1,250
Class C-2	1,100
Class D/E	1,500
All Classes – premium adjustment calculation	18,978
Total reinsurance payable	$24,853

Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

Amounts Withheld for the Account of Others **$1,099**

This liability represents employee payroll deductions in the possession of the company at December 31, 2003. Due to the size of this account (less than ½% of surplus), substantive testing was not considered necessary.

Payroll Taxes Payable **$420**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2003, which had not yet been paid. Due to the size of this account (less than ½% of surplus), substantive testing was not considered necessary.

Accounts Payable **$450**

This liability represents meetings fees due to directors, phone bills, and other miscellaneous payables. Due to the size of this account (less than ½% of surplus), substantive testing was not considered necessary.

Premiums Received in Advance **$38,192**

This liability represents the total premiums received prior to year end for policies with effective dates after December 31, 2003. The examiners reviewed 2003 premium and cash receipt records to verify the accuracy of this liability.

V. CONCLUSION

A total of eight recommendations and one suggestion were made and there was one adjustment to surplus. Of particular importance is the need to accurately report the company's in-force records.

Also discussed in the report, was the company's low, but attainable, breakeven point and its contributing factors. Such contributing factors include increasing reinsurance costs and the company's concentration of risk in one geographic area. Management is anticipating a decrease in reinsurance costs in the near future. Yet, management would be sensible to consider contingencies (such as a merger) in the event that reinsurance costs do not decrease.

The company appears to be serving policyholders well by maintaining a sufficient amount of surplus, maintaining a risk adverse investment portfolio, and making timely claim payments.

In conclusion, the examination determined that the company had surplus of $487,966, total admitted assets of $646,624, and 396 policies in force at year-end December 31, 2003.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 15 - Conflict of Interest—It is recommended that the minutes of the board of directors identify when a director abstains from a vote where there is a conflict of interest.

2. Page 16 - Underwriting—It is recommended that the company obtain signatures for the undertaking to pay premium and assessments for all policies that are currently in force, as required by s. 612.52, Wis. Stat.

3. Page 17 - Claims Adjusting—It is recommended that the company comply with s. 612.13 (4), Wis. Stat., by appointing an adjusting committee and noting the committee members in the board minutes.

4. Page 17 - Accounts and Records—It is recommended that the company correctly report information on Schedule M according to the Town Mutual Annual Statement Instructions.

5. Page 19 - Invested Assets— It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards custody and control of its invested assets.

6. Page 20 - Investment Rule Compliance—It is recommended that the company complete the Schedule of Investment Limitations according to the Town Mutual Annual Statement Instructions and s. Ins 6.20 (6), Wis. Adm. Code.

7. Page 22 - Premiums, Agents' Balances in Course of Collection—It is recommended that the company comply with annual statement instructions regarding Premiums, Agents' Balances in Course of Collection.

8. Page 24 - Unearned Premiums—It is recommended that unearned premiums be calculated from the company's full term premium as stated in s. Ins 13.08 (3), Wis. Adm. Code.

9. Page 25 - Unearned Premiums—It is suggested that the company use the daily pro rata method to calculate unearned premiums on a going forward basis.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Angela Graff of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

Bill C. Genné
Examiner-in-Charge